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SUBJECT: JAPAN ECONOMIC SCOPE - APRIL 13, 2007

¶1. (U) This cable contains the Japan Economic Scope for April 13, 2007.

¶2. (U) Table of Contents

¶3. GOJ for Joint Study for a U.S.-Japan Free Trade Agreement?
¶4. U.S. Chamber Chief Cites FTA and Autos as Key Issues
¶5. Has Reg Reform "Peaked Out?"
¶6. Government Advisor Speaks on Broad Economic Reforms
¶7. Amakudari Reform Proposals Watered Down
¶8. Investment Working Group DVC
¶9. Japanese Labor Productivity Lagging
¶10. Japan's Cyber University Becomes A (Virtual) Reality
¶11. Toyota Officials' Concerns and on U.S. Production Plants
¶12. Lessons for Reg Reform? EPA Auto Visit Exemplar of Transparency
¶13. Honda Saitama Production Plant Visit
¶14. Meeting with MLIT Policy Official on Asia Gateway Initiative
¶15. Asia Gateway Panel Member on the Asia Gateway Initiative
¶16. Sendai Airport Hub for China Flights
¶17. Japan Foreign Steamship Association and Japanese Port Operations
¶18. Summary of Selected GOJ Documents Released for Public Comment through April 6, 2007

¶3. (SBU) GOJ for Joint Study for a U.S.-Japan Free Trade Agreement?

As we have reported previously, a subcommittee of the Council on Economic and Fiscal Policy (CEFP) studying Japan's strategies for bilateral / regional trade agreements and agricultural reform will issue an interim report on its discussions later this April.

On April 11, the subcommittee posted on the CEFP's website a reference document reflecting on-going discussions among its members that will be used as the basis for the interim report. On free trade agreements, the discussion covered a range of topics, including the now traditional argument that Japan should first sign a pact with the Association of Southeast Asian Nations (ASEAN).

It shows that Japan should set out to pursue regional trade agreements, naming as examples ASEAN plus 3, ASEAN plus 6 and APEC-wide FTAs, while noting Japan will host APEC in 2010.

In addition it recommends a joint study on a U.S. - Japan Free Trade

Agreement that would cover not only trade, but also investment and services. Several Japanese business leaders have argued that Japan should pursue an FTA with the United States, including the heads of Keidanren, the Japan Chamber of Commerce and Industry, and the Japan Association of Corporate Executives (Keizai Doyukai).

However, according to a subcommittee member, the Ministry of Foreign Affairs and the Ministry of Agriculture are still cautious about a possible FTA with the United States.

On agriculture, the document suggested creating a five year road map on enhancing productivity.

The subcommittee leader, Professor Urata of Waseda University, revealed to the press his views that "gaiatsu, i.e., foreign pressure" would be needed to leverage agriculture reform. He mentioned politicians who prefer the current situation are the reason why agricultural reform does not proceed, and requested Prime Minister Abe to show the same attitude toward agricultural reform as former Prime Minister Koizumi showed for Postal Privatization.

According to the Cabinet Office, the final version of the report should come out by June and be incorporated into the CEFP's "Basic Policies 2007", after being taken up and discussed by the full CEFP. Our contact also revealed that whether the joint study on U.S.-Japan FTA will be reflected in the "Basic Policy 2007" is still subject to discussion within the CEFP.

14. (SBU) U.S. Chamber Chief Cites FTA and Autos as Key Issues -----

The U.S. Chamber of Commerce currently does not support a U.S. - Japan FTA, its president Tom Donahue told the Ambassador April 2.

TOKYO 00001701 002 OF 006

Instead, the Chamber wants both governments to focus on completing the Doha Round negotiations first. Donahue said he now gives Doha a 60 percent chance of success, up from just 20 percent in January.

The Ambassador expressed hope that Donahue's optimism would be fulfilled, but cautioned against linking Doha to a possible bilateral FTA negotiation. This argument is being used in Japan by those seeking a narrow agreement containing items of interest to Japanese industry while dodging a comprehensive undertaking including agriculture.

On autos, Donahue said U.S. labor and the big three manufacturers believe they can apply their China currency argument to Japan and has launched a campaign in Congress along these lines. The evidence of yen/dollar manipulation is nil, however, and Donahue quoted the Tokyo GM representative as denying that the yen is to blame for the U.S. industry's difficulties.

15. (SBU) Has Reg Reform "Peaked Out?" -----

PM Abe's lack of interest in economic policy and a mistaken notion that regulatory reform has led to income disparity has dampened enthusiasm for continued reform efforts said a member of the Council for the Promotion of Regulatory Reform (CPRR) during an April 11 meeting with EMIN.

As a result, stodgy bureaucrats are regaining confidence and putting up more resistance to change than in the Koizumi era. CPRR's only allies are the U.S. Embassy and the Japanese Business Federation (Keidanren), and indeed CPRR members are viewed as USG "spies," the member joked. It is unlikely that the situation will improve after the July elections as the LDP probably will not win big and the DPJ and Komeito parties are not pro-reform.

The Council member stated he is not overly optimistic that the Japan-Australia FTA negotiations will have a large impact on the agricultural sector as the farm lobby is exceedingly strong. Without a change in the tax code that would levy a tax on uncultivated land, there is no incentive for farmers to sell or rent their small plots and therefore no way to increase efficiency

through consolidation. Agricultural reform may be achieved in fifteen or twenty years, however, as elderly farmers become unable to work the fields and slowly leave the scene, he predicted.

Perhaps a more fruitful area of U.S. focus is the medical services sector, he suggested. The Japanese public is dissatisfied with the level of medical care available and also with the long wait times to get an appointment. The excitement over the recent opening of the Johns Hopkins Medical Clinic could be evidence of the public's willingness to have high-quality, U.S. medical service providers in Japan. The Council member added, however, that the medical lobby is also quite strong.

For more information, please contact Sally Behrhorst.

16. (SBU) Government Advisor Speaks on Broad Economic Reforms

Naoki Tanaka, Chairman of the Postal Services Privatization Committee, advisor to PM Abe, and head of the newly established Center for International Public Policy Studies, gave a policy speech April 11 on broad reforms necessary for the Japanese economy.

Given the challenges of a rapidly aging society, a declining number of workers, international financial imbalances, and global warming, Tanaka identified fiscal consolidation, increased productivity, health care reform, governmental decentralization, and pension fund reform as key goals for the Japanese government. He singled out increased openness to trade and foreign direct investment as tactics through which to foster development in his target areas.

Asked about postal privatization after his presentation, Tanaka stated that some Diet members were saying Japan should retreat from that reform, but that "we will not permit that." He then connected the re-routing of funds from postal savings away from government bonds (and, thereby, a source of cheap funds for municipalities) as a step that would increase Japanese receptivity to foreign direct investment over the next seven to eight years.

TOKYO 00001701 003 OF 006

17. (SBU) Amakudari Reform Proposals Watered Down

Reform proposals for the amakudari ("descent from heaven") retirement system, whereby senior bureaucrats are placed in plum private sector jobs, continue to be watered down as they move forward. The government and ruling coalition came to internal agreement April 12 to establish a government-wide job bank for bureaucrats that was initially proposed as an effort to remove line ministries from the outplacement of its own bureaucrats. Official acceptance of the policy is expected April 13.

The agreed plan, according to newspaper reports, will create the job bank and prohibit ministries from making direct outplacements, but will allow those line ministries' human resources departments to cooperate with the central job bank in the outplacement process. The agreement delays full implementation until 2011, weakens the role of an outside advisory body, and proposes the repeal of regulations that currently prohibit (for two years) officials from taking employment with certain companies their ministries regulate.

Noting that the highest and most powerful bureaucrats face the biggest potential losses from meaningful reform, an embassy contact doubted the long-term significance of the proposed job bank. He speculated that, while reform of the amakudari system is popular, making the reform effective would require a political effort on the scale of former PM Koizumi's push to realize postal privatization.

18. (SBU) Investment Working Group DVC

The second session of the bilateral Investment Working Group for the current fiscal year took place April 13 via digital videoconference. The Working Group reviewed progress on all agenda items in advance of the annual report to leaders in June.

The two sides expressed satisfaction with the results of the February information exchange on BIT's and FTA's and agreed both countries took similar approaches to negotiating investment chapters. We agreed to begin reaching out to the private sector for its views on the investment climate, possibly as early as May.

On educational services, the Ministry of Education, Culture, Sports, Science and Technology announced, as of April 1, it had expanded nationwide, existing regulations limited to special zones for structural reform that allow universities to lease, not own, their physical facilities. This should facilitate market entry of new foreign universities by reducing start-up costs.

On merger and acquisitions, the Ministry of Economy, Trade and Industry (METI) announced the promulgation of final rules on tax deferral for triangular merges on April 13. (The rules closely follow the draft that the Embassy shared with Washington last month.) Both sides agreed the market would be the final judge of whether triangular mergers become an effective tool for increasing investment flows. METI resisted U.S. calls to conduct a formal study of the impact of the tax deferral rules sometime before the end of 2008 but said it would constantly "monitor" the merger and acquisitions situation going forward and emphasized there had been no change to the GOJ's policy of actively encouraging inward FDI.

19. (SBU) Japanese Labor Productivity Lagging

Japan's labor productivity is just 71 percent that of the United States, according to a recently released Cabinet Office report. It is also lower than Europe's (87 percent), Britain's (83 percent), and the OECD average (75 percent). Moreover, the gap in productivity between the United States and Japan, which had narrowed in the 1970s and 1980s, held steady in the late 1990s, and has slightly widened since.

The report dings Japan's service sector for the country's lagging performance, noting that productivity in the transport sector, which was about half of the United States' in 1980, fell to less than 35 percent by 2005. Relative retail sector productivity is also low and declining, at less than 60 percent.

The Council on Economic and Fiscal Policy is expected to take up the
TOKYO 00001701 004 OF 006

topics of productivity and deregulation as it charts a new national economic strategy. Likely in preparation for that discussion, the Cabinet Office report highlights how productivity increases in the distribution, financial services, transport, and business services sectors have driven U.S. growth since 2000.

110. (U) Japan's Cyber University Becomes A (Virtual) Reality

On April 1, Japan's first online university, Cyber University, held its inaugural ceremony in Fukuoka's Yahoo Dome, with students attending both in person and via computer.

Operated by Japan Cyber Education Institute in Fukuoka, Cyber University was approved in November 2006 as part of the GOJ's deregulation program to revitalize economic and business activities.

The university currently has two departments, information technology and world heritage, and offers non-traditional students the opportunity to earn a four year bachelor's degree online. Among other options, students can "attend" classes by using a personal computer connected to a broadband communication network.

A total of 516 students are already enrolled at the university and each department hopes to eventually have 600 students each.

The tuition for a four-year online education is 2.7 million yen (USD 23,000).

Internet and telecom conglomerate Softbank Corp owns a 71 percent stake in the university, with the remainder held by Kyushu Electric Power Co. and RKB Mainichi Broadcasting Corp.

11. (SBU) Toyota Officials' Concerns and on U.S. Production Plants

We met with two executives from Toyota's Global External Affairs division to discuss general issues and Toyota's U.S. operations on April 9.

The Toyota officials were concerned about possible U.S.-Japan auto frictions; the change in power in the Congress; the comfort women issue clouding the Abe-Bush summit; and the impact of the Korea - U.S. FTA agreement on Japanese automakers, particularly in regards to trucks. They predicted that the KORUS FTA would give impetus to Japanese thinking about a U.S.-Japan FTA.

We also discussed the pros and cons of putting an auto plant in Michigan, but they emphasized Toyota made decisions on locations based on production needs not politics. For more information on the meeting please contact Josh Handler.

12. (SBU) Lessons for Reg Reform? EPA Auto Visit Exemplar of Transparency

EPA Assistant Administrator for Enforcement and Compliance Assurance Granta Nakayama and EPA Director of Air Enforcement Division Adam Kushner came to Tokyo on April 9-11 for meetings with Ministry of Environment officials and the automobile industry to explain EPA's enforcement and compliance work.

Under the rubric of an "ounce of prevention is worth a pound of cure," Nakayama invited Japanese automakers in meetings with the Japanese Automobile Manufacturers Association and at an all day visit to Honda's Saitama production plant to have more contact with Nakayama's office so any questions with compliance could be addressed early on in their design and production process, thus heading off potential enforcement problems.

Nakayama said that his office hears frequently from U.S. industries of all sorts including the U.S. automakers, but rarely from the Japanese automakers despite their significant presence in the United States.

Nakayama and Kushner also met with the Japanese Automobile Importers Association to learn about enforcement and compliance issues in Japan.

TOKYO 00001701 005 OF 006

Initial suspicions on the part of JAMA and Honda gave way to relief and then appreciation for the high-level EPA delegation for making the trip and effort to reach out. Both promised future cooperation and follow-up. The EPA delegation was encouraged by the positive response. EPA will be following up in Washington, DC, with the auto industry and tentatively plans to return to Japan in a year.

Econoff who attended the meetings with the auto industry was struck by the contrast between the EPA approach to transparency and some of the GOJ ministries we deal with here regularly. It would be a red-letter day if Ministry of Land, Infrastructure and Transport officials flew to the United States to ask U.S. airlines to have more of a dialogue about Japanese aviation policy.

13. (SBU) Honda Saitama Production Plant Visit

Econoff toured Honda's Saitama plant along with the EPA officials on April 11 and participated in an afternoon long meeting on compliance issues.

Located about an hour north of Tokyo, Honda's Saitama plant, although only one football field by three in area, is the largest of

three Honda car plants in Japan, producing some 540,000 vehicles a year, a substantial portion of Honda's 3,630,000 worldwide vehicle production.

The plant operates two lines, one for CRV production for export to the United States, which produces 1,120 cars a day, and a second which produces 1,050 vehicles of several different models for the U.S. and Japanese markets. Seventy-two percent of the production is for export. Thirty-three percent of the vehicles are sedans, 41 percent are SUVs and 26 percent are MPVs.

The line operates at a fast clip and, from start to finish, it takes about three hours to produce a vehicle. The vehicles only sit on the limited sized parking lot for a few hours before being whisked off by truck to Narashino Port in Chiba prefecture for shipment.

The plant employs 6,856 associates of which 1,412 are temporary staff. Plant managers say the plant's strong points are a highly efficient manufacturing process in a limited space and highly motivated workforce which utilizes good communications to achieve its high production targets. Notable are the energy efficiency improvements the plant has made since 1992 when Honda adopted a declaration on the environment which called for saving energy and reducing toxic emissions. In the early 1990s, 172 liters of crude oil equivalent were needed to produce a vehicle. In 2006, it was 129 liters, a reduction of 25 percent. The Honda officials did not know if this energy saving was representative of Japanese industry as a whole, but they felt their plant was better than those of Toyota or Nissan.

¶14. (SBU) Meeting with MLIT Policy Official on Asia Gateway Initiative

We met with an official of the Ministry of Land, Infrastructure and Transport's (MLIT) Policy Division on March 30, who is the point of contact with the Cabinet for issues related to PM Abe's Asia Gateway Initiative at MLIT and will be coordinating MLIT's response to the Asia Gateway Panel's interim report.

The official said MLIT is critical of the open skies proposals in the Asia Gateway Panel's interim report and those made by non-governmental members of the Council for Economic and Fiscal Policy's. MLIT is wary of the term open skies as it is associated with U.S. policy initiatives to open the aviation market in Japan, while what is under discussion is not liberalization of air traffic with Japan, but deregulation of regional airports. For more information on the meeting please contact Josh Handler.

¶15. (SBU) Asia Gateway Panel Member on the Asia Gateway Initiative

We met with a member of PM Abe's Asia Gateway Council on March 29 to discuss the Gateway Initiative. The panel member is a specialist on relations with Asia and had had conversations with former PM Koizumi, PM Abe and former Chief Cabinet Secretary Yasuo Fukuda about Japan-Asia relations, before being selected to serve on the

TOKYO 00001701 006 OF 006

council.

The panel member discussed Abe's attitudes towards Asia, the political future of the Asia Gateway initiative, Open Skies, and the debate over Haneda Airport's internationalization. He said that, although the Asia Gateway and Opens Skies initiative is usually talked about in the context of Asia only, he is hopeful that the Asia Gateway initiative will expand to the rest of the world. For more information on the meeting please contact Josh Handler.

¶16. (U) Sendai Airport Hub for China Flights

On March 18, rail service opened between Sendai International Airport and Japan Railway's Sendai Station. Previously, travelers from downtown Sendai could only reach the airport by a 40-minute bus or car ride. Now, they can arrive in less than 20 minutes for a

reduced fare using the government-funded Sendai Airport Access Line.

In addition, the rail line provides a convenient means of transfer for Shinkansen passengers from outside of Sendai who use the region's largest airport.

The new rail service is part of a larger strategy by Miyagi Prefecture to encourage increased use of Sendai Airport as a hub for travel to northern Japan's Tohoku region. Other plans include expanding the number of international direct flights between Sendai and China as well as developing the area surrounding the airport into a new business and entertainment district.

In February, the Diamond City Airy, Tohoku's largest shopping mall, opened just two rail stations away from Sendai airport.

117. (SBU) Japan Foreign Steamship Association and Japanese Port Operations

We met with representatives of the Japan Foreign Steamship Association (JFSA) on March 20 to discuss port operations in Japan and their views on recent changes in Japanese law governing port operations. The JFSA has 28 member companies and is a voluntary nonprofit organization that seeks to help its members do business in Japan.

The JFSA representatives described their concerns with Japanese port operations - primarily the lack of competition for stevedoring operations for international shippers and high costs. They acknowledged they are reluctant to press their concerns for fear of jeopardizing business. They supported the EU and U.S. regulatory reform positions, but were unsure of what additional steps foreign governments could take. For more information on the meeting please contact Josh Handler.